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In The

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1981

No._____

UTILITY CONSUMERS COUNCIL
OF MISSOURI, INC.,

Petitioner,

v.

PUBLIC SERVICE COMMISSION
OF MISSOURI, and UNION
ELECTRIC CO.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE MISSOURI COURT OF APPEALS, WESTERN DISTRICT

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QUESTIONS PRESENTED

1. Whether regulated utility rates which allow the recovery of revenue sufficient to pay tax expenses which are known to be non-existant in addition to that revenue necessary to pay the real costs of service and provide a reasonable return are in violation of due process and equal protection requirements?

2. Whether Internal Revenue Code provisions conditioning the grant of current tax benefits to regulated utility companies upon regulatory action by state regulatory commissions allowing the recovery of revenue by such companies as though the taxes forgiven were actually to be paid is within the Congressional powers, particularly the taxing power, and whether such provisions unconstitutionally invade the powers reserved to the States.

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OPINION BELOW

The Opinion of the Court of Appeals is reported at 606 SW2d 222 and is attached hereto as Appendix A.

JURISDICTION

The Judgment of the Court of Appeals was entered on September 2, 1980. A timely Motion for Rehearing or Transfer to the Missouri Supreme Court was overruled on October 1, 1980 by the Court of Appeals. A timely Application to Transfer to the Supreme Court of Missouri was denied on November 12, 1980, and this Petition was filed within 90 days of that date. Jurisdiction is involved under 28 U.S.C. §1257(3).

STATUTORY PROVISIONS INVOLVED

Copies of Internal Revenue Code §§46(f) and 167(l) are attached as Appendix B.

STATEMENT UNDER RULE 28.4(b)

Since the proceeding draws into question the constitutionality of IRC §46(f) and 167(l), Acts of Congress affecting the public interest, and neither the United States nor any agency, officer, or employee thereof is a party, it is noted that 28 U.S.C. §2403(a) may be applicable.

STATEMENT OF THE CASE

This case arises from an application for increased electric rates filed by Respondent Union Electric Co. (hereafter Respondent Company) for its service area within the State of Missouri. The rate filing was heard by the Missouri Public Service Commission (hereafter Respondent PSC) which issued an Order on January 19, 1978, which, after correction, became effective on February 2, 1978. Petitioner Utility Consumers Council of Missouri, Inc., an Intervenor representing consumers, particularly residential consumers, of electricity within the service area and throughout the State of Missouri, appealed the order by way of filing a Petition for Writ of Certiorari and Review in the Circuit Court of Cole County, Missouri. The Circuit Court affirmed the PSC order, and on appeal the Missouri Court of Appeals also affirmed.

The appeal was limited to issues

involving the legality of the inclusion of "deferred" income tax items as expenses which Respondent Company can recover from its ratepayers. In the proceedings before the Respondent PSC rates were set in the ordinary manner based on test year information. The Respondent PSC held hearings and based on the evidence found that the Company was entitled to recover a revenue sufficient to pay its proven expenses and provide a fair return on its investment. Neither the rate structure or the reasonability of the allowed rate of return has been appealed.

In computing expenses for the test year, the Respondent Company included certain items of income tax expense which it knew would not have to be paid. The Respondent PSC in its order allowed these fictitious income tax expenses to be included as real expenses. (PSC Order 26 and App. A, Sheet 3). It is not disputed that these taxes will not have to be paid

(PSC Tr. 792-806); although in some instances it is claimed that taxes not paid during the period of the test year computation may be related to a higher amount of income taxes in a future year.

There were several types of deferred taxes included in this case. Deferred taxes which are equal to the taxes which would have been paid if the Internal Revenue Code did not allow accelerated depreciation for tax purposes were allowed (PSC Tr. 792-795). As to these non-taxes it is argued that IRC §167(l) would deny all or part of the benefit if the Respondent PSC refused to include them as expenses. Similarly with Investment Tax Credit given by the Internal Revenue Code, it is argued that the IRC §46(f) would require the denial of the tax benefit if the Respondent PSC refused to include the non-taxes as expenses. (PSC Tr. 792, 3).

Other items of non-tax result simply from Internal Revenue Code allowance of

current tax deductions for expenditures which were properly amortized or placed in construction work in progress accounts for rate-making purposes. There is nothing in the Internal Revenue Code linking these benefits to inclusion of these non-taxes in the ratemaking expense. (PSC Tr. 804-806).

The Court of Appeals held that the Respondent PSC's Order approving the inclusion of non-taxes in the recoverable expense was supported by good and valid reasons and within its zone of allowable discretion. (App. A, 19). Petitioner has contended throughout that allowance of non-taxes amounts to a confiscation of the ratepayers property and a violation of the Constitutional ratemaking standards repeatedly enunciated by this Court, and that the Internal Revenue Code provisions which penalize the utility companies if the regulatory commissions set lawful rates by excluding non-taxes are beyond the legitimate powers of Congress. The PSC and the

Circuit Court did not rule specifically on the questions. The Court of Appeals held that the proposition that only present expense should be charged to ratepayers was flexible enough to allow the "normalization" method if there are good reasons for it, App. A, 12, and that the IRC provisions were not invalid because it was open to Respondents, at least initially, to forego other tax benefits. (App. A 13-14).

REASONS FOR GRANTING THE WRIT

1. THE COURT SHOULD DETERMINE WHETHER OR NOT THE DECISION OF THE COURT BELOW CONFLICTS WITH ESTABLISHED CONSTITUTIONAL STANDARDS FOR SETTING REGULATED UTILITY RATES WHICH HAVE BEEN ENUNCIATED BY THIS COURT.

The practice of allowing normalized non-taxes in current utility rates is followed to some extent in all the jurisdictions of the United States and results in hundreds of billions of dollars of extra revenue being paid annually to the nation's regulated utility companies by their customers. Liberman, Normalized Taxes in Utility Rates: Giving Credits Where None are Due, 30 S. Car. L.R. 703, 706 (1979). This extremely inflationary practice has contributed to rising utility prices affecting every citizen of the nation and hampering the ability of government to provide effective service. The pattern of this subsidization of utility stockholders is one which has encouraged a growing over-capacity in the electric

utility industry and further penalization of ratepayers in the form of the costs necessary to uphold this capacity. (Id., 705, fn. 4).

This Court has never ruled on the serious legal questions as to the validity of this practice. These questions involve fundamental issues as to the proper exercize of governmental power. The charging of non-taxes to current utility ratepayers, even in those instances where there might be higher future taxes related to current tax benefits, amounts to the making of fiscal policy by the regulatory Commission. It is equivalent to an exercize of the taxing power by an administrative body in the guise of carrying on the quasi-adjudicative role of ratemaking. As will be pointed out in Sec. 2 below, there are equally serious issues concerning use of the federal taxing power in a manner which tends to coerce the regulatory agencies into unlawful ratemaking.

This court has long recognized and enforced constitutional limitations on the administration of regulated utility monopolies. The leading case is Smyth v. Ames, 169 U.S. 466, 523-24, 544-47 (1898) where the Court held that rates which fail to provide sufficient revenue and a reasonable return violate the due process and equal protection rights of the utility company by confiscating its property without fair compensation. Similarly the court recognized that rates which provide more than a reasonable return are a confiscation of the ratepayers property. Id., 544, 547; Chicago Mil. & St. P. Ry. v. Minn., 134 U.S. 418, 458 (1890).

Much of the litigation in this area has focussed on defining the zone of reasonability in the rate of return. Although legal definitions and rules have changed, the Court has consistantly re-affirmed the constitutional duty to set rates within the

zone of reasonability. Fed. Power Comm'n. v. Natural Gas Pipeline Co., 315 U.S. 575, 585-6; (1942); Fed. Power Comm'n. v. Hope Natural Gas, 320 U.S. 591, 607 (1944). However, the Court has considered the expense part of the equation also and firmly ruled that fictitious expense cannot be allowed. Galveston Elec. Co. v. City of Galveston, 258 U.S. 388 (1922); Acker v. United States, 298 U.S. 426, 429 (1936).

The question which must be decided is whether this fundamental rule can be avoided by what is essentially an accounting gimmick for including non-existant tax expense. The Constitutional dimension of the problem is emphasized by the admission of all concerned that what is happening is simply a conscription of capital funds from the ratepayers, without any payment of dividend or interest and in some cases without a return of the principle.

This case arises in the area of substantive due process, and for that reason

review may be uncomfortable due to the notion that substantive due process has been totally rejected. For this reason Petitioners emphasize that the Court review of reasonability of rates charged by utility monopolies has never been abandoned and is in fact required by the allowance of monopoly power to a privately held company. Munn v. Illinois, 94 U.S. 113 (1976).

It may be that the Court has in the past 50 years limited its constitutional role in the area regarding oversight of legislative economic regulation. It is still appropriate for the Court to review administrative decisions taken in an adjudicative capacity which have a confiscatory effect. This is particularly true where, as here, the administrative decision is in reality an exercize of legislative power by a non-legislative body.

Moreover, in this case the allowance of unreal expenses makes all the rest of the ratemaking proceeding a farce. If

additional revenue returns can be provided by the allowances of admittedly fictitious expense the whole proceedings as to the proper rate of return and the real costs becomes a meaningless sham. The phoniness of such ratemaking proceedings is apparent to anyone who has attended or participated in one in the past ten years. The results are virtually unreviewable administrative decisions. Review of the issues raised in this case is required by the principle that rates are to be set according to legal rules and procedures, rather than by the unfettered discretion of regulatory bodies.

2. THE COURT SHOULD DETERMINE WHETHER CONGRESS HAS PROPERLY EXERCIZED ITS POWER WITHIN THE CONFINES OF ARTICLE I AND THE TENTH AMENDMENT IN ENACTING INTERNAL REVENUE CODE PROVISIONS WHICH COERCE THE STATE AND FEDERAL REGULATORY COMMISSIONS TO SET UNLAWFUL AND UNCONSTITUTIONAL RATES.

The decision below correctly held that §§46(f) and 167(l) of the Internal Revenue Code do not absolutely require the regulatory commissions to charge the ratepayers for non-taxes. (App. A,14). However, the conditions deny the tax benefits in question to the regulated company in question if the regulatory commissions fails to do so.

This raises questions regarding the limits of the use of Congressional taxing power for non-revenue purposes, which have not been adequately dealt with either by the Court below or any other court.

This court has recognized that Congress may achieve non-tax purposes through a tax law, but it has consistantly required that the tax produce revenue. Moreover in each of these cases the regu-

latory purpose was in aid of regulation of questionable if not illegal activity under state law. United States v. Kahriger, 345 U.S. 22 (1953); United States v. Sanchez, 340 U.S. 42 (1950); Sonsinsky v. United States, 300 U.S. 506 (1937). The tax laws challenged in this case do not produce any revenue to the contrary, they limit the tax revenue which the Internal Revenue Service would otherwise receive. Further, rather than aiding state regulation or being neutral in respect thereto, these laws throw the state regulatory process into chaos making the state proceedings unreviewable and ridiculous.

The decision of this Court in Steward Machine Co. v. Davis, 301 U.S. 548 (1937) has left unresolved important questions as to the power of Congress to intravene in matters otherwise left to the states. In the 44 years since that decision the Court has not determined whether the Congress may

condition private tax benefits upon state governmental activity which has no relationship to the fiscal need for the foregone taxes, where state governmental activity is thereby severely disrupted, where there is no valid purpose for the tax benefit or for its withholding and where the federal tax revenue which might conceivably result from withdrawal of the benefit as a penalty do not relate in any way to the conditioned activity.

More recent decisions indicate that the Tenth Amendment may protect the state and their citizens from such unwarranted upset of their normal governmental processes. National League of Cities v. Usery, 426 U.S. 833, 852 (1976); EPA v. Brown, 431 U.S. 99 (1977)(Per Curiam).

Although these may be difficult questions, they are fairly presented for review in this case and a decision regarding them is necessary in order to resolve the proper relationship of state and federal

government as well as the proper roles of the legislative, judicial and administrative branches of government. Petitioners contend that under the decision of the Court below, the administrative ratemaking body has exercized legislative powers in the most crucial of legislative areas, taxing and fiscal policy, resulting incidentally in extremely inflationary fiscal policy. At the same time the Congress has invaded the adjudicative ratemaking process in an equally unlawful and inept manner, upsetting the whole traditional process.

While it would be improper for the Court to take over either the legislative or ratemaking function, it is entirely within the judicial power to define the limits of those powers, within the context of a ratemaking appeal. The Court below was reluctant to involve itself with these issues because of what it perceived as administrative complexity. Petitioner does not believe that the issues herein are as

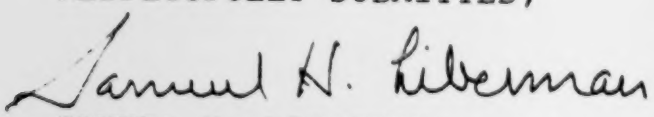
complex as Respondents have attempted to present them. However, even if the issues are complex, the case presents a good illustration of the governmental breakdown which occurs when the Courts fail to perform their duty of keeping each branch within its proper limits. Because of the monumental importance of re-establishing the rule of law in the ratemaking process Petitioners submit that review of this case should be undertaken.

CONCLUSION

For the foregoing reasons, the Petitioner Utility Consumers Council of Missouri Inc. respectfully prays that a writ of certiorari issue to review the judgment and opinion of the Missouri Court of Appeals, Western District entered in this proceeding on September 2, 1980.

Dated: February 9, 1981
Brooklyn, New York

RESPECTFULLY SUBMITTED,



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APPENDIX A

IN THE MISSOURI COURT OF APPEALS

WESTERN DISTRICT

STATE OF MISSOURI, ex rel. UTILITY CONSUMERS COUNCIL OF MISSOURI, INC.,	)	No. WD 31071
Petitioner-Appellant,	)	Opinion Filed September 2, 1980
v.	)	
PUBLIC SERVICE COMMISSION OF MISSOURI and UNION ELECTRIC CO.,	)	
Respondents.	)	

APPEAL FROM THE CIRCUIT COURT
OF COLE COUNTY

HONORABLE JAMES T. RILEY, JUDGE

Before Wasserstrom, C.J., Presiding, Kennedy and Pritchard, JJ.

The sole issue in the present case is the propriety of the Public Service Commission's allowance in a rate case of deductions by Union Electric Company of "normalized" federal and state income taxes, as opposed to the smaller amount of income taxes actually paid during the test year, in arriving at cost of service. The test year ended June 30, 1977. The Commission

allowed a $30,755,498 rate increase effective on February 2, 1978. The appeallant Utility Consumers Council of Missouri, Inc., argues that the Commission improperly allowed the company to treat $24,510,500 in "normalized" or "deferred" federal and state income taxes, and not actually paid out during the test year, as expenses in computing the cost of service.

The difference between the amount of "normalized" taxes allowed by the Commission and the amount of taxes actually paid out by the utility arises from the differences in the accounting treatment of certain items for ratemaking purposes on the one hand and for income tax purposes on the other. Those items are accelerated depreciation, investment tax credit, and certain construction expenses.

Scope of Review.

Before we take up the arguments of the parties, we first take up the matter of the scope of our review. Sec. 386.510, RSMo

1978, says that we review the order or decision of the Commission for "reasonableness and lawfulness". It is really not our business here to weigh the arguments for the "normalization" method which the Commission has ordered, and the arguments for the "flow through" method for which the Utility Consumers Council contends, and to decided which preponderates. That is for the Commission. If the Commission's decision to allow the normalization method is not unlawful, if it is supported by reason, and is not arbitrary or capricious, then it is our task to affirm the Commission's decision. We do not substitute our judgment or our discretion for that of the Commission. The complaining party carries the burden of making a convincing showing that the Commission's order is not reasonable or lawful. State ex rel. Chicago, Rock Island & Pacific Railroad Company v. Public Service Commission, 312 S.W.2d 791, 796 (Mo. banc 1958); Empire Dist. Elec. Co.

V. Cox, 588 S.W.2d 263, 266 (Mo. App. 1979); State ex rel. Beaufort Transfer Co. v. Clark, 504 S.W.2d 216, 217 (Mo. App. 1973); State ex. rel. Cape Girardeau v. PSC, 567 S.W.2d 450, 454 N.4 (Mo. App. 1978).

We not take up in order the arguments of the parties:

Accelerated depreciation.

For income tax purposes, the Internal Revenue Code allows the use of accelerated depreciation, resulting in larger annual deductions in the early years of the life of a depreciable asset and smaller deductions in later years. For ratemaking purposes, a depreciable asset is presumed to depreciate at a constant rate, and the cost basis is deducted ratably over the life of the asset. Respondent's brief furnishes the following comparison of the results of the straight line method (the method used for ratemaking purposes) and a form of accelerated depreciation known as the sum-of-the-years digits method: For

an asset costing $1,000,000, with an estimated useful life of 10 years, the straight line depreciation deduction would be $100,000 per year over the life of the asset. This is the method used for ratemaking calculations. By the sum-of-the-years digits method, used by the company for income tax purposes, the first year depreciation would be $181,818. That amount would decrease each year until in the tenth year the final depreciation deduction would be $18,181.

There is no disagreement about the use of the straight line method to arrive at the correct deduction for ratemaking purposes. The dispute is over the treatment of the income tax "saving", actually a deferral, resulting from the use of the accelerated depreciation method.

By "normalization", which was allowed in the present case, the income tax expense item allowed to be deducted in arriving at cost of service are not the taxes actually

paid, but are the amount which would have been paid had the straight line depreciation method resulted in an income tax deferral of $5,474.678 over the amount which the straight line depreciation method would have produced. This deferred amount was credited to a "deferred tax" reserve. In later years, when the depreciation deduction is less than the straight line method would yield, and the resulting taxes more than the straight line method would have produced, the excess tax will be deducted from the reserve. Over the life of the asset, assuming constant tax rates, the total depreciation deduction and the total income tax reduction resulting therefrom, will be the same by either method. By the accelerated depreciation method, the depreciation deduction will be more in the early years and the income tax less, and the situation will be reversed in later years.

The Utility Consumer Council's criticism of the Commission's decision is

that the deferred taxes which are allowed by the Commission's order to be charged to the ratepayers are actually a fictitious expense. To quote from appellant's brief, their position is as follows: "The income taxes paid by the company to the federal or state government in one year, should appropriately be charged to the customers buying company service in that year . . . 'Deferred' taxes are not expenses at all, but, at best, estimates of future taxes, which are charged to current ratepayers. . . Moreover, the whole idea of deferring expenses so as to 'even them out' over long periods of time, is at odds with the basis system employed by the PSC to set rates. The idea of applying test year information to a ratemaking formula is to try to base rates on actual costs of service at a particular moment".

The "deferred tax reserve", to which the deferred amounts are credited, is an

unfunded reserve. It creates, while it is in existence, a cost-free addition to capital. The appellant says that this is an interest-free loan from the ratepayers to the utility, for the ratepayers have paid it in and the utility does not pay it out. The Commission and the utility answer that the reserved amount is instead a loan from the United States Treasury to the utility. Whichever way one looks at it, it is a sum upon which the utility pays no interest. The amount of it is excluded from the rate base so the rates charged to the ratepayers do not include a return upon the reserved amount. The reserve therefore insures to the benefit of the ratepayers in that the rates do not reflect any cost for the use of the money. This feature provides an immediate benefit to the ratepayers.

Should normalization of taxes not be allowed, and "flow through" required, the substantial tax benefits of accelerated depreciation would be lost to the utility,

Internal Revenue Code, §§167(l) and 46(f); City of Akron v. Public Utilities Commission 51 Ohio St. 2d 27, 364 N.F.2d 869 (Ohio, 1977). In the latter case, the court said: "Since the accounting procedure for normalization uses straight line depreciation which then creates a reserve for the tax obligation resulting from the tax deferral, the effect is that all of the rates and expenses stay the same in any event, but the utility loses the advantage of using the reserve fund as cost-free capital, which it would have if it uses both the accelerated depreciation method and normalization. . .Since we conclude that the Commission's inclusion in the rate-making formula as an expense for the test year of the tax figure arrived at by normalizing tax liability computed by the accelerated depreciation method was neither unreasonable nor unlawful, and that under these facts the determination by the Commission that normalization is in the best interests of

of the ratepayers, the order of the Commission is affirmed." Id. at 870.

The normalization of taxes as ordered by the Commission in this case is widely accepted in rate cases. See Fed. Power Commission v. Memphis Light, Gas & Water Division, 411 U.S. 458 (1973); Cities of Lexington, etc., v. Federal Power Commission 295 F.2d 109, 111 (4th Cir. 1961); Colorado Municipal League v. Public Utilities Commission, 597 F.2d 586 (Colo. banc 1979); City of Alton v. Illinois Commerce Commission, 165 N.E.2d 513, 520 (Ill. 1960); New England Telephone & Telegraph Company v. Public Utilities Commission, 390 A.2d8 (Maine, 1978); Re Hackensack Water Company, 57 N.J. Super. 180, 154 A.2d 212, 219 (1959); City of Akron v. Public Utilities Commission, supra. See also Swiren, Accelerated Depreciation Tax Benefits in Utility Rate Making, 28 U. of Chicago L. Rev. 629 (1961). See also the following regulatory agency cases approving the

normalization method: Re Hudson Water Company, 28 PUR 4th 617, 620 (N.H. Pub. Util. Comm. 1979); Re Southwestern Public Service Company, 27 PUR 4th 302, 315 (N.M. Pub. Serv. Comm. 1978); Re Kansas Power & Light Company, 20 PUR 4th 54, 59 (Kan. State Corp. Comm. 1977); Re Mountain States Telephone & Telegraph Co., 22 PUR 4th 516, 538-40 (Col. Pub. Util. Comm. 1977); Re East Ohio Gas Co., 16 PUR 4th 137, 151 (Ohio Pub. Util. Comm. 1976); Re Arizona Public Service Company, 20 PUR 4th 253, 258-59 (Ariz. Corp. Comm. 1977).

In contending for the "flow-through" system of accounting, by which the income tax component is the amount if income tax actually paid out, the appellant says that the normalization method "is at odds with the basic system employed by the PSC to set rates". It says that "(t)he idea of applying test year information to a rate-making formula is to try to base rates on actual costs of service at a particular moment."

It cites in support of that proposition State ex rel. Capital City Water Company v. Public Service Commission, 252 S.W. 446, 449 (Mo. banc 1923), which held that past losses could not be capitalized and charged to present or future customers. They also cite State ex rel. Valley Sewage Company v. Public Service Commission, 515 S.W.2d 845, 851 (Mo. App. 1974), and State ex rel. Martigny Creek Sewer Company v. Public Service Commission, 537 S.W.2d 388, 394, (Mo. banc 1976), both of which held that customers' contributions in aid of construction must be deducted appellant nor with the general proposition that present expenses are to be charged to present ratepayers. The latter proposition, though, is a very broad one and a very flexible one. It does not prevent the allowance by the Commission of the normalization method of computing the income tax component of the cost of service, if, as we have shown above, there are good reasons for it.

To counter the utility's position, adopted by the Commission, that denying normalization would result in a loss of the tax benefits of accelerated depreciation, appellant Utility Consumers Council attacks the validity of those sections of the Internal Revenue Code which purport to deny accelerated depreciation and investment tax benefits to those companies which do not "normalize" them but which flow them through to net income and hence to the ratepayer. See Internal Revenue Code, §§167(l) and 46(f). Appellant views these sections as requiring normalization by the Public Service Commission. Appellant then argues that this requirement is an unconstitutional intrusion by Congress upon state functions and violative of the Tenth Amendment to the United States Constitution. Leaving aside the effect of a pronouncement by this court in this proceeding, to which the federal government is not a party, that these provisions of the Internal Revenue

Code are unconstitutional and invalid, the answer to the appellant's contention is that its premises is incorrect. The cited sections of the Internal Revenue Code do not require normalization. The choice of normalization or "flow-through" was open to the utility, in the first instance, and to the Commission. It might have rejected normalization and have foregone the tax benefit, if other considerations outweighed the tax advantages to be gained by normalization. Sec. 393, 270.4, RSMo 1978. It chose, however, upon weighing the features of the two methods, to normalize. We find no constitutional infirmity in the Internal Revenue Code sections cited, and we reject the appellant's point.

Investment tax credit.

A regulated utility like other businesses is allowed an income tax credit of 11% of any amount invested in certain qualifying assets. In our case, only the portion above 4% (i.e., the additional

amount authorized by the Tax Reduction Act of 1975) was normalized and is at issue here. The income tax credit amount to $6,911,280. This credit was not "flowed through" to the ratepayers by adding it to net income for ratemaking purposes. It was instead amortized over the life of the property to which it related. The credit was allowable only if normalized. It would have been disallowed if "flowed through". Internal Revenue Code, §§167(l) and 46(f).

Appellant correctly points out that the investment tax credit is an actual tax saving and not a tax deferral. In this respect it is unlike the accelerated depreciation, which results in a tax deferral rather than an outright saving.

Appellant fails to demonstrate how the decision of the Commission to normalize the investment tax credit costs the ratepayers, present or future, anything at all.

Appellant says: "A PSC order contradicting [the provisions requiring normal-

ization in order to claim the investment tax credit] by denying normalization would, at worst, not change the rates, as the ratepayers would pay the same either way" - an argument which says that if the investment tax credit cannot be "flowed through" to the ratepayers, it should be foregone altogether! The ratepayers do, however, gain from normalization of the investment tax credit, as well as the accelerated depreciation and the construction expense deductions, the indirect benefit of an enhanced cash flow for the utility. It is difficult to see how the Commission could reasonably have denied normalization of the investment tax credit. It costs the utility customers nothing, but gives to the utility, to the indirect benefit of the customers, an improvement in cash position. See Southern Cal. Gas Co. v. Public Utilities Comm'n., 591 F.2d 34 (Cal banc. 1979).

Construction expenses.

There is a third category of expenses

which are capitalized for rate-making purposes, but currently deducted from income for income tax purposes. These expenses are interest, property taxes, pensions and other costs charged to construction. They are not permitted, for rate-making purposes, to be "flowed through" to the ratepayer as incurred. Sec. 393.135, RSMo 1978, prohibits the company from earning any return upon facilities before they are actually placed in service. They are added to the costs of the production facilities, then amortized over the life of the facility, beginning when the facility is placed in service. These expenses, currently deducted for income tax purposes, result in a reduction of income taxes. By the tax normalization method, approved by the Commission's order in this case, the income tax saving resulting from the current deduction of these expenses is not "flowed through" at once to the ratepayers, but reduces the cost of the facility to which

the expenses relate. Thus the income tax saving for the test year $12,124,542 - and the construction expenses to which they relate, are both amortized over the life of the facility, beginning with the time the facility is placed in service. There is logic and fairness in this method. The immediate flow-through of income taxes saved, as the appellant would require, would result in a windfall to present ratepayers. Not having to pay the construction expenses, they would yet get the benefits of the income tax deduction resulting therefrom. Later ratepayers, while paying the expenses by way of depreciation, would not have the benefit of any tax deduction therefrom. Cf. Memphis Light, Gas & Water Div. v. Fed. Power Comm'n., 500 F.2d 798, 806-7 (D.C. Cir. 1974).

As in the case of tax savings from acclerated depreciation and from investment credit, normalization does provide for the ratepayers the indirect benefit of an en-

hanced cash flow for the utility.

Conclusion.

We conclude that the Commission's order approving normalization of income taxes in the three areas mentioned, i.e., accelerated depreciation, investment tax credit, and construction expenses, is supported by good and valid reasons. The appellant has not demonstrated either that they are unlawful or unreasonable. The least that can be said for the Commission's order is that it was within the zone of an allowable discretion, which is not be be disturbed upon judicial review. Cf. Tenneco Oil Co. v. Federal Energy Comm'n., 571 F.2d 834, 842-844 (5th Cir. 1978); El Paso Natural Gas Co. v. Fed. Power Comm'n., 449 F.2d 1245 (1971).

"It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by state and federal legislation to admini-

strative regulatory tribunals whose decision in the absence of abuse of discretion should be followed by the courts." Cities of Lexington, etc., Ky. v. Federal Power Commission, supra at 114 (4th Cir. 1961).

The judgment of the trial court is affirmed.

All concur.

Don W. Kennedy, Judge

APPENDIX B

INTERNAL REVENUE CODE

Sec. 46(e)

(e) Limitations with respect to certain persons.—

(1) In general.—In the case of—

(A) an organization to which section 593 applies, and

(B) a regulated investment company or a real estate investment trust subject to taxation under subchapter M (sec. 851 and following),

(2) Ratable share.—For purposes of paragraph (1), the ratable share of any person for any taxable year of the items described therein shall be—

(A) in the case of an organization referred to in paragraph (1)(A), 50 percent thereof, and

(B) in the case of a regulated investment company or a real estate investment trust, the ratio (i) the numerator of which is its taxable income and (ii) the denominator of which is its taxable income computed without regard to the deduction for dividends paid provided by section 852(b)(2)(D) or 857(b)(2)(B), as the case may be.

For purposes of subparagraph (B) of the preceding sentence, the term "taxable income" means in the case of a regulated investment company its investment company taxable income (within the meaning of section 852(b)(2)), and in the case of a real estate investment trust its real estate investment trust taxable income (within the meaning of section 857(b)(2)) determined without regard to any deduction for capital gains dividends (as defined in section 857(b)(3)(C)) and by excluding any net capital gain.

(3) Noncorporate lessors.—A credit shall be allowed by section 38 to a person which is not a corporation with respect to property of which such person is the lessor only if—

(A) the property subject to the lease has been manufactured or produced by the lessor, or

(B) the term of the lease (taking into account options to renew) is less than 50 percent of the useful life of the property, and for the period consisting of the first 12 months after the date on which the property is transferred to the lessee the sum of the deductions with respect to such property which are allowable to the lessor solely by reason of section 162 (other than rents and reimbursed amounts with respect to such property) exceeds 15 percent of the rental income produced by such property.

In the case of property of which a partnership is the lessor, the credit otherwise allowable under section 38 with respect to such property to any partner which is a corporation shall be allowed notwithstanding the first sentence of this paragraph. For purposes of this paragraph, an electing small business corporation (as defined in section 1371) shall be treated as a person which is not a corporation.

(f) **Limitation in case of certain regulated companies.**—

(1) **General rule.**—Except as otherwise provided in this subsection, no credit shall be allowed by section 38 with respect to any property which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) **Cost of service reduction.**—If the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection); or

(B) **Rate base reduction.**—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

Subparagraph (B) shall not apply if the reduction in the rate base is restored not less rapidly than ratably. If the taxpayer makes an election under this sentence within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, the immediately preceding sentence shall not apply to property described in paragraph (5)(B) if any agency or instrumentality of the United States having jurisdiction for ratemaking purposes with respect to such taxpayer's trade or business referred to in paragraph (5)(B) determines that the natural domestic supply of the product furnished by the taxpayer in the course of such trade or business is insufficient to meet the present and future requirements of the domestic economy.

(2) **Special rule for ratable flow-through.**—If the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraph (1) shall not apply, but no credit shall be allowed by section 38 with respect to any property which is public utility property (as defined in paragraph (5)) of the taxpayer—

(A) **Cost of service reduction.**—If the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by more than a ratable portion of the credit allowable by section 38 (determined without regard to this subsection), or

(B) **Rate base reduction.**—If the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable by section 38 (determined without regard to this subsection).

(3) **Special rule for immediate flow-through in certain cases.**—In the case of property to which section 167(*l*)(2)(C) applies, if the taxpayer makes an election under this paragraph within 90 days after the date of the enactment of this paragraph in the manner prescribed by the Secretary, paragraphs (1) and (2) shall not apply to such property.

(4) **Limitation.**—

(A) **In general.**—The requirements of paragraphs (1), (2), or (9) regarding cost of service and rate base adjustments shall not be applied to public utility property of the taxpayer to disallow the credit with respect to such property before the first final determination which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect with respect to public utility property (to which this subsection applies) of the taxpayer. Thereupon, paragraph (1), (2), or (9) shall apply to disallow the credit with respect to public utility property (to which this subsection applies) placed in service by the taxpayer—

(i) before the date that the first final determination, or a subsequent determination, which is inconsistent with paragraph (1), (2), or (9) (as the case may be) is put into effect, and

(ii) on or after the date that a determination referred to in clause (i) is put into effect and before the date that a subsequent determination thereafter which is consistent with paragraph (1), (2), or (9) (as the case may be) is put into effect.

(B) **Determinations.**—For purposes of this paragraph, a determination is a determination made with respect to public utility property (to which this subsection applies) by a governmental unit, agency, instrumentality, or commission or similar body described in subsection (c)(3)(B) which determines the effect of the credit allowed by section 38 (determined without regard to this subsection)—

(i) on the taxpayer's cost of service or rate base for ratemaking purposes, or

(ii) in the case of a taxpayer which made an election under paragraph (2) or the election described in paragraph (9), on the taxpayer's cost of service for ratemaking purposes or in its regulated books of account or rate base for ratemaking purposes.

(C) **Special rules.**—For purposes of this paragraph—

(i) a determination is final if all rights to appeal or to request a review, a rehearing, or a redetermination, have been exhausted or have lapsed,

(ii) the first final determination is the first final determination made after the date of the enactment of this subsection, and

(iii) a subsequent determination is a determination subsequent to a final determination.

(5) **Public utility property.**—For purposes of this subsection, the term "public utility property" means—

(A) property which is public utility property within the meaning of subsection (c)(3)(B), and

(B) property used predominantly in the trade or business of the furnishing or sale of (i) steam through a local distribution system or (ii) the transportation of gas or steam by pipeline, if the rates for such furnishing or sale are established or approved by a governmental unit, agency, instrumentality, or commission described in subsection (c)(3)(B).

(6) **Ratable portion.**—For purposes of determining ratable restorations to base under paragraph (1) and for purposes of determining ratable portions under paragraph (2)(A), the period of time used in computing depreciation expense for purposes of reflecting operating results in the taxpayer's regulated books of account shall be used.

(7) **Reorganizations, assets acquisitions, etc.**—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the

application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

(8) **Prohibition of immediate flowthrough.**—An election made under paragraph (3) shall apply only to the amount of the credit allowable under section 38 with respect to public utility property (within the meaning of subsection (a)(7)(D)) determined as if the Tax Reduction Act of 1975, the Tax Reform Act of 1976, the Energy Tax Act of 1978, and the Revenue Act of 1978 had not been enacted. Any taxpayer who had timely made an election under paragraph (3) may, at his own option and without regard to any requirement imposed by an agency described in subsection (c)(3)(B), elect within 90 days after the date of the enactment of the Tax Reduction Act of 1975 (in such manner as the Secretary shall prescribe) to have the provisions of paragraph (3) apply with respect to the amount of the credit allowable under section 38 with respect to such property which is in excess of the amount determined under the preceding sentence. If such taxpayer does not make such an election, paragraph (1) or (2) (whichever paragraph is applicable without regard to this paragraph) shall apply to such excess credit, except that if neither paragraph (1) nor (2) is applicable (without regard to this paragraph), paragraph (1) shall apply unless the taxpayer elects (in such manner as the Secretary shall prescribe) within 90 days after the date of the enactment of the Tax Reduction Act of 1975 to have the provisions of paragraph (2) apply. The provisions of this paragraph shall not be applied to disallow such excess credit before the first final determination which is inconsistent with such requirements is made, determined in the same manner as under paragraph (4).

(9) **Special rule for additional credit.**—If the taxpayer makes an election under subparagraph (B) of subsection (a)(2), for a taxable year beginning after December 31, 1975, then, notwithstanding the prior paragraphs of this subsection, no credit shall be allowed by section 38 in excess of the amount which would be allowed without regard to the provisions of subparagraph (B) of subsection (a)(2) if—

(A) the taxpayer's cost of service for ratemaking purposes or in its regulated books of account is reduced by reason of any portion of such credit which results from the transfer of employer securities or cash to an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Reduction Act of 1975;

(B) the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan; or

(C) any portion of the amount of such credit which results from a transfer described in subparagraph (A) to such employee stock ownership plan is treated for ratemaking purposes in any way other than as though it had been contributed by the taxpayer's common shareholders.

(l) Reasonable allowance in case of property of certain utilities.—

(1) Pre-1970 public utility property.—

(A) In general.—In the case of any pre-1970 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(i) a subsection (*l*) method, or

(ii) the applicable 1968 method for such property.

Except as provided in subparagraph (B), clause (ii) shall apply only if the taxpayer uses a normalization method of accounting.

(B) Flow-through method of accounting in certain cases.—In the case of any pre-1970 public utility property, the taxpayer may use the applicable 1968 method for such property if—

(i) the taxpayer used a flow-through method of accounting for such property for its July 1969 accounting period, or

(ii) the first accounting period with respect to such property is after the July 1969 accounting period, and the taxpayer used a flow-through method of accounting for its July 1969 accounting period for the property on the basis of which the applicable 1968 method for the property in question is established.

(2) Post-1969 public utility property.—In the case of any post-1969 public utility property, the term "reasonable allowance" as used in subsection (a) means an allowance computed under—

(A) a subsection (*l*) method,

(B) a method otherwise allowable under this section if the taxpayer uses a normalization method of accounting, or

(C) the applicable 1968 method, if, with respect to its pre-1970 public utility property of the same (or similar) kind most recently placed in service, the taxpayer used a flow-through method of accounting for its July 1969 accounting period.

(3) Definitions. For purposes of this subsection—

(A) Public utility property.—The term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of

(i) electrical energy, water, or sewage disposal services,

(ii) gas or steam through a local distribution system,

(iii) telephone services, or other communication services if furnished or sold by the Communications Satellite Corporation for purposes authorized by the Communications Satellite Act of 1962 (47 U.S.C. 701), or

(iv) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(B) Pre-1970 public utility property.—The term "pre-1970 public utility property" means property which was public utility property in the hands of any person at any time before January 1, 1970.

(C) Post-1969 public utility property.—The term "post-1969 public utility property" means any public utility property which is not pre-1970 public utility property.

(D) Applicable 1968 method. The term "applicable 1968 method" means, with respect to any public utility property—

(i) the method of depreciation used on a return with respect to such property for the latest taxable year for which a return was filed before August 1, 1969,

(ii) if clause (i) does not apply, the method used by the taxpayer on a return for the latest taxable year for which a return was filed before August 1, 1969, with respect to its public utility property of the same kind or if there is no property of the same kind, property of the most similar kind) most recently placed in service, or

(iii) if neither clause (i) nor (ii) applies, a subsection (*l*) method.

In the case of any section 1250 property to which subsection (*j*) applies, the term "applicable 1968 method" means the method permitted under subsection (*j*) which is most nearly comparable to the applicable 1968 method determined under the preceding sentence.

(E) Applicable 1968 method in certain cases. If the taxpayer evidenced the intent to use a method of depreciation (other than its applicable 1968 method or a subsection (*l*) method) with respect to any public utility property in a timely application for change of accounting method filed before August 1, 1969, or in the computation of its tax expense for purposes of reflecting operating results in its regulated books of account for its July 1969 accounting period, such other method shall be deemed to be its applicable 1968 method with respect to such property and public utility property of the same (or similar) kind subsequently placed in service.

(F) Subsection (*l*) method. The term "subsection (*l*) method" means any method determined by the Secretary to result in a reasonable allowance under subsection (a), other than (i) a declining balance method, (ii) the sum of the years-digits method, or (iii) any other method allowable solely by reason of the application of subsection (b)(4) or (j)(1)(C).

(G) Normalization method of accounting.—In order to use a normalization method of accounting with respect to any public utility property—

(i) the taxpayer must use the same method of depreciation to compute both its tax expense and its depreciation expense for purposes of establishing its cost of service for ratemaking purposes and for reflecting operating results in its regulated books of account, and

(ii) if, to compute its allowance for depreciation under this section, it uses a method of depreciation other than the method it used for the purposes described in clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from the use of such different methods of depreciation.

(H) Flow-through method of accounting.—The taxpayer used a "flow-through method of accounting" with respect to any public utility property if it used the same method of depreciation (other than a subsection (*l*) method) to compute its allowance for depreciation under this section and to compute its tax expense for purposes of reflecting operating results in its regulated books of account.

(I) July 1969 accounting period.—The term "July 1969 accounting period" means the taxpayer's latest accounting period ending before August 1, 1969, for which it computed its tax expense for purposes of reflecting operating results in its regulated books of account.

For purposes of this paragraph, different declining balance rates shall be treated as different methods of depreciation.

(J) Special rules as to flow-through method.—

(A) Election as to new property representing growth in capacity. If the taxpayer makes an election under this subparagraph before June 29, 1970, in the manner prescribed by the Secretary, in the case of taxable years beginning after December 31, 1970, paragraph (2)(C) shall not apply with respect to any post-1969 public utility property, to the extent that such property constitutes property which increases the productive or operational capacity of the taxpayer with respect to the goods or services described in paragraph (3)(A) and does not represent the replacement of existing capacity.

(B) **Certain pending applications for changes in method.**—In applying paragraph (1)(B), the taxpayer shall be deemed to have used a flow-through method of accounting for its July 1969 accounting period with respect to any pre-1970 public utility property for which it filed a timely application for change of accounting method before August 1, 1969, if with respect to public utility property of the same (or similar) kind most recently placed in service, it used a flow-through method of accounting for its July 1969 accounting period.

(5) **Reorganizations, assets acquisitions, etc.**—If by reason of a corporate reorganization, by reason of any other acquisition of the assets of one taxpayer by another taxpayer, by reason of the fact that any trade or business of the taxpayer is subject to ratemaking by more than one body, or by reason of other circumstances, the application of any provisions of this subsection to any public utility property does not carry out the purposes of this subsection, the Secretary shall provide by regulations for the application of such provisions in a manner consistent with the purposes of this subsection.

CERTIFICATE OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF KINGS)

I, SAMUEL H. LIBERMAN, being duly sworn, do hereby certify that on the day of February, 1981, three copies of this Petition for Writ of Certiorari were mailed, postage prepaid to Treva Jean Laska, Office of the General Counsel, Public Service Commission, P.O. Box 360 Jefferson City, Missouri 65101, Attorney for Respondent Public Service Commission, to Stewart W. Smith, William E. Jauder and Paul W. Agathen, P.O. Box 149, St. Louis, Missouri, 63166, Attorneys for Respondent Union Electric Co., and on the Solicitor General, Department of Justice, Washington, D.C. 20530. I further certify that 40 copies of this petition were mailed postage pre paid to the Clerk of the United States Supreme Court, Washington,

. D.C., 20543, for filing this 10th day of February, 1981.

Samuel H. Liberman
SAMUEL H. LIBERMAN

Subscribed and Sworn to
before me this 10th day
of February, 1981

Delia Rodriguez
NOTARY PUBLIC

DELIA RODRIGUEZ
Notary Public, State of New York
No. 24-4699150
Qualified in Kings County
Commission Expires March 30, 1981